

US Property's Quarterly Price Gains at Odds With Bearish Market But on Yearly Basis, Prices Drop and Point To Bear Market, CoStar Analysis Finds

By Mark Heschmeyer

U.S. prices for most commercial property types rose in the third quarter from the second quarter, but the reasons for the increase actually illustrate a bearish market, according to a CoStar Group analysis.

Gains were not consistent across markets, property type, quality, or size, according to Chad Littell, national director of capital markets analytics for CoStar and author of the monthly Commercial Repeat-Sale Indices report.

“For the first time since the first quarter of 2011, negative year-over-year price growth in prime markets confirms that commercial property price declines have become broad-based across property segments,” Littell said. “Nothing moves in a straight line. Year-over-year directional pricing trend is my North Star.”

CoStar's Value-Weighted U.S. Composite Index, reflecting big property sales common in major cities, rose 0.4% over the second quarter. Meanwhile, the Equal-Weighted U.S. Composite Index showing the more numerous, lower-priced property deals more common in smaller markets, climbed 2.1%.

Despite these increases, prices in large coastal markets, across all property types, are still down on a yearly basis, CoStar data shows.

The composition of assets sold is important to note, according to Littell. The office sector provides a good example. The only office properties really trading are either those with strong cash flows, and going for the highest prices, or buildings that need major improvements, which are trading at the lowest amounts.

The U.S. Prime Office Index fell 1.6% in the third quarter, taking its cumulative decline to negative 15.3% since the fourth quarter of 2022 and down 10% over the prior year.

“Investment-grade and value-weighted segments represent larger, more sophisticated deals, and you see that those segments are reacting as commercial estate should when [interest] rates go higher,” Littell said.

That the equal-weighted index rose 2.1% quarter to quarter is reflective of how small properties are purchased, according to Littell. They tend to be bought with cash, so the influence of interest rates is muted, he said.

“Long and short, my view is unchanged and is increasingly bearish,” Littell said. “Cheaper debt in the summer gave transaction markets a shot in the arm, along with thinking the war on inflation was won. Going forward, we have a sticky consumer price index, heavy Treasury issuance, wars to

fund, rising commodity pricing, slowing consumer spending, the end of the credit cycle, and an eroding commercial real estate supply/demand story. It's hard to find the bull case for commercial real estate today."

Price Trends by Property Type

Here are pricing results for the other main property types in the third quarter:

- **Industrial indices showed mixed results.** The equal-weighted U.S. Industrial Index gained 2.4% over the second quarter but logged its fourth consecutive quarter of declines in the value-weighted segment, which fell 0.9%. Prime industrial markets edged 1.9% lower than the prior quarter and 0.3% below levels in the third quarter of 2022.
- **Multifamily values leaped higher in primary markets.** Prime multifamily markets saw a 2.3% bounce in pricing compared to the second quarter. Those markets outperformed the overall multifamily index, which advanced by 2% over that prior quarter. The abundance of fixed-rate multifamily debt from federal housing and bank lenders helped goose prices as yields on benchmark rates moved sharply lower in the first half of 2023, according to Littell.
- **Prime retail pricing picked up after three down quarters.** The U.S. Prime Retail Index rose 2.3% in the third quarter after edging lower since the fourth quarter of 2022. The equal-weighted retail index also advanced 1.3% in the quarter while gaining 1.1% since the third quarter of 2022. Like the other property types, the value-weighted index showed pricing weakness and fell 0.4% during the quarter. Pricing also dipped 2.4% among the higher-quality assets compared to the third quarter of 2022.
- **The hospitality index marched higher.** Hotel prices rose 4% in the third quarter, contributing to annual gains of 6% in the 12 months ended in September. The U.S. Hospitality Index was 33.6% above its pre-recession peak in the third quarter.

The latest CoStar Commercial Repeat-Sale Indices report is based on 1,132 sale pairs in September and more than 296,739 repeat sales since 1996.